

FUNDAMENTAL LEGAL AND FISCAL PRINCIPLES

FOR PUBLIC BENEFIT FOUNDATIONS

The European Foundation Centre's European Union Committee with the help of its Legal and Taxation Task Forces has developed these draft *Fundamental Principles* as part of its project: "Enhancing the Legal Environment for Independent Funders in Europe". The project began with a review of foundations' operating framework, and by drawing up profiles of the legal and fiscal environment in which foundations operate in each of the Member States of the European Union. An overview of these 15 country profiles is now available. They form a basic database on legal and fiscal legislation and practices in the European Union and are intended to facilitate the identification of good practice on which a Model Law for a Public Benefit Foundation can be based.

These *Principles* are intended to apply to any foundation which is of 'public benefit' as opposed to 'private benefit'. Public benefit foundations can take different forms in Common Law and different Civil Codes, including trusts and 'non-autonomous' foundations such as exist in Germany and France¹.

The Principles have a threefold purpose. They:

- underpin the constituent elements of a model law for foundations
- can influence new foundation law and the revision of foundation law at national level
- contain the essential ideas for any EU legislation for foundations.

1. THE RIGHT TO CREATE

There should be a fundamental right, enshrined in European and national law, for any natural person or legal entity to create a public benefit foundation in any EU Member State.

There should be clear statutory provisions for the setting up of a foundation and, provided statutory requirements are met (see Principle 3), the State should have no discretionary power to decide whether a particular foundation should or should not be created. There should be a right for any natural person or legal entity to create a foundation whose purposes are legal and of public benefit.

¹ Similarly, 'non-autonomous' foundations also exist in Common law as 'special funds' of charitable foundations.

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The State or any public authority should be able to create a foundation, but any foundation so created must be independent. Foundations created by commercial enterprises could be funded by them, but they should be legally distinct and be operated independently of the commercial interests which create them.

Comment

This principle intends to introduce the right to create a foundation as soon as the requirements are fulfilled. The requirements may vary from one country to another but the principle of having the right to create a foundation should be a common rule.

The assumption is that it is public benefit foundations, which are the focus of the EUC and its Task Forces' interest. To draw a distinction between such foundations and other types of foundation by other than fiscal means may, however, already be controversial.

2. BASIC FUNCTIONAL DEFINITION

Foundations are *independent, separately constituted non-profit bodies with their own governing board and with their own source of income whether or not exclusively from an endowment*. They have been irrevocably attributed goods, rights and resources for the performance of work and support for *public benefit purposes*, either by supporting associations, institutions or individuals etc., or by operating their own programmes. Foundations have no members.

Public benefit foundations may be established for a limited period, but assets given over for public benefit purposes for such foundations may not revert to private ownership.

Comment

This definition excludes private purpose foundations.

3. CREATION

The law should introduce clear legal requirements for the establishment of a foundation.

It should be possible to create a foundation by notarial or trust deed, or by will. Both natural persons and legal entities may set up foundations.

Where the establishment of a foundation is linked to registration and/or approval by the competent authority, the creation of a foundation should be an administrative matter: that is to say that, providing the administrative requirements for the creation of a foundation are met, the State should have no discretion in the matter (see Principle 1). In particular, the competent authority should not be entitled to make decisions on political grounds.

However, the competent authority should be able to refuse to approve or to register an applicant foundation if, and only if, it deems the purposes of the foundation to be illegal; or if necessary for the protection of public security or safety; the prevention of

crime and disorder; the protection of health and morals; or protection of the rights and freedoms of others.

4. FOUNDATIONS' REGISTER

As a matter of good practice foundations should register. Registration should take place on receipt by the registration authority of the foundation's statutes, and business address (or addresses if it intends to establish branches in other countries) together with the names of its board members. This information, once verified by the registration authority, should be made publicly available. The registration authority should be notified about the changes.

As a matter of good practice and administrative efficiency, the registration authority should also be the body responsible for supervision (see Principle 15).

Comment

The registration authority could be part of the public administration and/or funded by the State, but should be independent of the government in its authority and decision making in individual cases.

5. LEGAL PERSONALITY

In general, all foundations should have legal personality, except non-autonomous foundations that exist in some countries. Foundations acquire legal personality in different ways in the Member States of the EU: in some countries, foundations acquire it without approval or registration; in most countries, however, state approval or registration is needed.

6. LEGAL CAPACITY

Foundations should have the right to hold movable and immovable property and to engage in any activity, which is legal, allowed for in its statutes, and consistent with its public benefit status (see Principles 8 and 10.) Foundations should be able to receive and hold gifts of any kind, including shares and other negotiable instruments, and gifts 'in kind', *from any lawful source and without the permission of any public or supervisory authority.*

7. GOVERNANCE

Foundations have their own governing structure, usually in the form of a board. The law or the statutes of the foundation could make provision for additional structures. As a matter of good practice, where an individual founder, or a family, establishes a foundation, the founder and his/her relatives should not be the only members of the board.

Members of the governing structures, and officers of the foundation, should observe a duty of loyalty in the exercise of their responsibilities to the foundation; should act with diligence and care; and should ensure obedience to the laws and statutes of the foundation.

Comment

The introduction of a 'governance principle' is intended to underline the importance of foundations' boards and good governance. It also touches upon the issue of the disclosure of governance structures and practices. This topic is currently being discussed by EU experts in the context of a review of company law in Europe. In addition, care needs to be taken to ensure that no particular section of society is in practice – for example for reasons of poverty or work patterns – discriminated against in relation to serving on the boards of foundations.

8. PUBLIC BENEFIT PURPOSES

A 'public benefit purpose' should be any lawful purpose that supports or promotes public benefit by supporting or promoting, *for example*, one or more purposes from the following list. It should be noted that this list is intended to be illustrative, not definitive, and that the topics are not in any order of priority or desirability. This list is open to other purposes determined to be of public benefit.

- Arts, culture and historical preservation
- Assistance to, or protection of people with disabilities
- Assistance to refugees and immigrants
- Civil or human rights
- Consumer protection
- Development, international and domestic
- Ecology or the protection of environment
- Education, training, and enlightenment
- Elimination of discrimination based on race, ethnicity, religion, disability, or any other legally proscribed form of discrimination
- Health or physical well-being and medical care
- Humanitarian or disaster relief
- Prevention and relief of poverty
- Promotion of European and international understanding
- Protection of and support for children and youth
- Protection of and support for disadvantaged individuals
- Protection or care of animals
- Science
- Social cohesion, including the promotion of respect for minorities
- Social and economic development
- Social welfare
- Sports, amateur athletics

Comment

Whatever list is chosen, it should be as wide as possible and subject to change from time to time so that the notion of public benefit remains responsive to social needs and to public perceptions of what is worth supporting with tax concessions. The list should be of purposes that are presumed to be of public benefit. The presumption of public benefit ought, however, to be rebuttable on the grounds, for example, that services provided are not needed or appropriate for a particular area or public, or where the beneficiaries constitute in effect an 'elite'.

9. THE NOTION OF 'PUBLIC'

To qualify as being of public benefit, a foundation should serve the whole public or a significant group within the general population. Its purposes should be amongst those enumerated in the principle on public benefit purposes above and not disallowed for any reason.

In no case could the foundation serve essentially private interests. There should be a strict non-distribution constraint. Assets, earnings, and profits of a foundation should be used to support the public benefit purposes of the foundation and should not be directly or indirectly used to provide benefits to any founder or donor (*qua founder or donor*) of the foundation.

On dissolution, any remaining assets should be spent on public benefit or made over to another public benefit organisation with objectives as similar as possible to those of the defunct organisation.

10. TRADING/ECONOMIC ACTIVITIES

A foundation should have the capacity, and be free, to engage in trading or other lawful economic activities provided that the results are clearly and directly used in pursuance of its public benefit purposes and do not constitute the aim of the foundation. Income may be earned from 'unrelated' economic activity, but such activity must not form the foundation's main activity.

Comment

The idea behind this principle is that foundations can undertake economic activity (trading goods and services) as long as the activity is used to facilitate the pursuance of its public benefit purpose either directly or by using the income of this activity.

11. POLITICS

A foundation should be able to engage freely in research, education, publication, and advocacy with respect to any issue affecting the public interest, including criticism of the policies or activities of the government or the State or of particular laws. It should not, however, be permitted to fundraise or campaign in support of, or opposition to, any political party or candidate for appointive or elective public office, or otherwise engage in 'party' politics.

Comment

Political parties are also non-profit bodies, but distinct ones. Quite apart from the desirability of maintaining the confidence of the largest possible section of the public, it would seem wise to distance foundations as far as possible from possible political fundraising activities and campaigns.

12. AMENDMENT OF THE STATUTES

Any amendment of the bylaws, insofar as they affect the purposes of the foundation, should be consistent with the will of the founder.

Any changes proposed by the board to the purposes of the foundation as set out in the bylaws should be approved by the registration/supervision authority and given publicity. In general, the purposes of the foundation should only be changed under clearly defined circumstances (e.g. the purpose has already been achieved or cannot be achieved).

13. DISSOLUTION OF THE FOUNDATION

(a) Voluntary dissolution

The board of the foundation should be able to decide upon dissolution in clearly defined cases (if the aim of the foundation is achieved or the total loss of assets has taken place). In any case, the board decision has to be approved by the registration/supervision authority.

(b) Involuntary dissolution

The dissolution of foundations should be the *ultima ratio* measure of any registration/supervision authority.

14. TRANSPARENCY AND ACCOUNTABILITY

Foundations should be obliged to keep accounts and to provide an annual report of their activities, and to lodge both documents annually with the registration/supervision authority. In addition, larger foundations should have their accounts professionally audited.

It would be desirable if accounts and reports, together with the foundation's bylaws and details of its board, were publicly available.

Comment

We are of the opinion that foundation registers lead to transparency. Increased coherence between the many different reporting, accounting and auditing systems is recommended.

15. SUPERVISION

With the aim of maintaining public confidence in the sector, means of supervision should exist, above all to ensure the foundation's financial probity and good governance and that its continued public benefit status is merited. The supervisory authority, whether or not it is also the registration authority should have available to it a range of sanctions designed to deal with mismanagement or abuse.

The scope of the supervisory authority should be clearly defined in law and its jurisdiction must be exercisable in practice.

Comment

It is an open question whether the registration authority should also be the body having the power to supervise foundations. Practical considerations suggest that it should be.

16. LIABILITY

The liability of a foundation should be limited to its assets. Members of the governing structure should be liable to injured third parties for the wilful or grossly negligent performance or neglect of their duties, or for criminal acts, but should not otherwise be personally liable.

17. APPEALS

Any decision of the registration and supervisory authorities should be appealable to the courts.

18. TAX TREATMENT OF THE FOUNDATION, DONORS AND BENEFICIARIES

The rules to apply for tax exemption of the foundation as well as tax incentives for the donor should be clear and user-friendly. Tax relief schemes should be clearly defined in the law and should not be at the discretion of the competent authority.

There should be a presumption that all foundations engaged in public benefit activities (see Principle 8) are entitled to be relieved of the taxes listed below. Tax relief could be dependent on the *expenditure of the foundation's income for public benefit purposes*. In other words, foundations should be expected to spend their resources at a reasonable rate. That rate should not, however, be defined in law. Each case should be treated on its merits. Furthermore, income judged as having been expended on activities other than those defined as being of public benefit should be taxed in the normal way.

Comment

The question of what reserves it would be proper or prudent for a foundation to hold, or the rate at which, given differing economic conditions, it should spend its endowment, can only sensibly be answered in the context of each foundation and each public benefit activity. As a matter of principle, tax exemptions should only be given to foundations that seek them.

There should be approaches to agree of a common definition of general interest purposes leading to tax benefit at the national level, as this would be an important step to facilitate cross-border giving.

(a) Income tax

Foundations should be relieved of income taxation on money or other items of value received from whatever legal source (e.g. individual donors, companies, governments or other NGOs, whether from home or abroad) whether by donation,

grant, contract or testament. Relief should also be given for income from interest on capital or other funds, dividends, rents, royalties or capital gains earned on assets or the sale of assets. Losses of foundations should be taken into account. Realised capital gains and losses should be reconciled with foundations' capital.

Comment

There is the tricky question here of whether income received by one foundation but earmarked for transmission to another should be regarded as 'income'. Given the scope of the arrangements being discussed here and the common definition of 'public benefit' suggested above, donations for onward transmission should either be regarded as income and be relieved of tax or as not constituting income at all. It does not seem to be a major issue to choose between either of these two rationales: the important point is that the tax system should facilitate rather than hinder cross-border giving.

(b) Taxation of economic activities

Profits from related economic activities of public benefit foundations should be free of tax as long as they are exclusively applied to the foundation's public benefit purposes. There should be a tax-free allowance for unrelated business income up to a certain ceiling. The economic activities of foundations must not constrain competition rules.

Comment

A question here is whether a wholly owned business could, as in the UK, covenant its profits to a foundation, which could receive them together with the tax 'paid' by the concern. The principle in this case would be that all profits destined for expenditure by a qualifying foundation (i.e. destined to be spent for public benefit) should be tax-free. Such a policy would, of course, raise the problem of unfair competition.

(c) Property and land taxes

Foundations should be relieved of all or a proportion of property and land taxes and from duties on the transfer of property or land.

Comment

The practice varies widely throughout the globe.

(d) Employment taxes

In principle, foundations have to pay social and other charges or to contribute to pension schemes where appropriate. However, where provisions are made for tax deduction of employment costs, this tax treatment should apply to foundations.

Comment

Exceptions might be made for employment under official job-creation schemes or for employment given as part of a special training scheme.

(e) Tax treatment of 'national' and 'foreign' foundations

The tax treatment of 'foreign' and 'national' foundations should be the same in each EU country. In particular, cross-border giving and the receipt of gifts across borders should attract identical tax relief, as should gifts or giving to or from foundations within or without the EU.

Comment

Whether it would be possible to achieve a situation where treatment was identical is impossible to predict. The most important thing is to ensure that while relief might continue to differ across the EU, the tax treatment of foundations is not discriminatory within jurisdictions.

(f) Company and individual donations

Both companies and individuals should be entitled to an income tax deduction or credit with respect to donations made to foundations engaged in activities of public benefit. The limits to be applied should be generous. In principle, the limits should be the same for all European citizens or companies giving to European foundations.

Comment

Governments cannot be expected to give up more than a certain proportion of tax receipts. It is an important question whether relief should be given by way of tax credits or by tax deductions. Credits are fairer in a progressive system, but deductions may persuade the wealthy to give more.

(g) Tax treatment of the beneficiary

In principle, where the beneficiary is a natural person, he/she should be exempt from tax on donations received from public benefit foundations up to a certain ceiling. The ceiling is to be further defined by tax law. Non profit organisations should be fully exempt from tax on donations received from public benefit foundations.

(h) Value-Added Tax (VAT)

VAT rules and their application should take into account the public benefit nature of foundations and their activities, and should in no case disadvantage foundations.
